

STATE CORPORATION COMMISSION

AT RICHMOND, OCTOBER 15, 2008

DOCUMENT CONTROL

APPLICATION OF

APPALACHIAN POWER COMPANY

2008 OCT 15 P 3: 17

CASE NO. PUE-2008-00067

To revise its fuel factor pursuant to
Va. Code § 56-249.6

ORDER ESTABLISHING FUEL FACTOR

On July 18, 2008, Appalachian Power Company ("Appalachian Power" or "Company") filed with the State Corporation Commission ("Commission") its application, written testimony, and exhibits requesting to increase its current fuel factor from 1.418¢ per kilowatt-hour ("kWh") to 2.255¢ per kWh, effective for bills rendered on and after September 1, 2008. The fuel factor revisions requested in Appalachian Power's application represent an estimated revenue increase through the Company's fuel factor of approximately \$176.7 million for the sixteen-month period from September 1, 2008, through December 31, 2009, or approximately \$132.5 million on an annual basis.

The Company's proposed fuel factor includes both an in-period factor and a prior period factor. The Company's proposed in-period factor of 2.121¢ per kWh is designed to recover the Company's total projected Virginia jurisdictional fuel expenses of approximately \$447.7 million for the period from September 1, 2008, through December 31, 2009. The Company's proposed prior period factor of 0.134¢ per kWh is designed to recover approximately \$28.3 million over the same sixteen-month period. This amount represents the Company's projected under recovery balance of fuel costs as of August 31, 2008.

On July 21, 2008, the Commission entered an Order Establishing 2008-2009 Fuel Factor Proceeding ("Scheduling Order") that, among other things: (1) established a

procedural schedule for this matter; (2) allowed the Company to place its proposed fuel factor into effect on an interim basis on September 1, 2008;¹ (3) required the Company to provide public notice of its application; and (4) scheduled a public hearing on the application for September 23, 2008.

The following parties filed notices of participation in this case on or before August 28, 2008: Steel Dynamics - Roanoke Bar Division ("SDI-Roanoke"); the VML/VACo APCo Steering Committee ("Steering Committee");² the Old Dominion Committee for Fair Utility Rates ("Old Dominion Committee");³ and the Office of the Attorney General's Division of Consumer Counsel ("Consumer Counsel"). In addition, the Commission received over 1,370 written or electronic comments and petitions containing over 2,900 signatures prior to the hearing on the Company's application.

The evidentiary hearing was held on September 23, 2008. The following were represented by counsel at the hearing: Appalachian Power; the Steering Committee; the Old Dominion Committee; Consumer Counsel; and Staff. In addition, one public witness, Senator Roscoe Reynolds, testified at the hearing.

¹ The Commission's July 21, 2008 Scheduling Order allowed the Company to place its proposed fuel factor into effect on an interim basis for bills rendered on and after September 1, 2008. On August 20, 2008, the Commission entered an Order Granting Motion which allowed the Company to place its proposed fuel factor into effect on an interim basis "for service" rendered on and after September 1, 2008, rather than "for bills" rendered on and after September 1, 2008.

² The Virginia Municipal League and the Virginia Association of Counties established the VML/VACo APCo Steering Committee, which is comprised of representatives of local governments and other political subdivisions of the Commonwealth served by the Company.

³ The members of the Committee are: Celanese Acetate, LLC; Corning Incorporated; Glad Manufacturing Company; Georgia-Pacific Corporation; Goodyear Tire & Rubber Company; and Grief Bros./Virginia Fibre Corporation.

Appalachian Power's proof of service and notice, as required by the Scheduling Order, was accepted into the record.⁴ The Company and the Commission Staff presented testimony and exhibits during the hearing. During opening statements, counsel for the Company, the Steering Committee, the Old Dominion Committee, and Consumer Counsel agreed with, or did not oppose, Staff witness Lamm's proposed fuel factor of 2.160¢ per kWh effective for service rendered on and after October 1, 2008.

NOW THE COMMISSION, upon consideration of this matter, is of the opinion and finds that the Company's interim fuel factor of 2.255¢ per kWh should be decreased to 2.160¢ per kWh effective for service rendered on and after October 20, 2008.

We share the concerns expressed by the Company's customers in their comments over the significant increase in the Company's fuel factor and its ultimate impact on customer bills. The price of fuel that the Company and its affiliates must purchase to generate electricity has risen significantly. Appalachian Power is statutorily entitled to recover its prudently incurred fuel costs under Va. Code § 56-249.6. Indeed, in describing this statutory provision almost twenty years ago, the Commission explained that the fuel factor statute permits *dollar for dollar* recovery of prudently incurred fuel costs.⁵ It should be noted, however, that the Company earns no profit on the fuel component of the fuel factor – it is simply a mechanism to recover the costs of fuel.

⁴ Exh. 1.

⁵ *Commonwealth of Virginia, ex rel. State Corp. Comm'n, Ex Parte: In the matter of establishing Commission policy regarding rate treatment of purchase power capacity charges by electric utilities and cooperatives*, Case No. PUE-1988-00052, 1988 S.C.C. Ann. Rept. 346, 347 (Nov. 10, 1988) (describing the "fuel factor" as "a statutory adjustment mechanism through which all prudently incurred energy costs are recovered, *dollar for dollar*" (emphasis added)). See also *Application of Kentucky Utils. Co., t/a Old Dominion Power Co., To revise its fuel factor pursuant to Virginia Code § 56-249.6*, Case No. PUE-1994-00043, 1995 S.C.C. Ann. Rept. 309, 310 (Jan. 6, 1995) ("*Kentucky Utils.*") (describing that the "fuel factor mechanism . . . gives the Company *dollar for dollar* recovery for allowable fuel expenses" (emphasis added)) and *Application of Virginia Electric and Power Company, To revise its fuel factor pursuant to Va. Code § 56-249.6*, Case No. PUE-2008-00039 (Order Establishing Fuel Factor, June 27, 2008) Doc. Cont. No. 398940.

Furthermore, and as also explained in prior fuel cases, approval of the fuel factor herein does not represent ultimate approval of the Company's fuel expenses. The instant Order Establishing Fuel Factor is based upon the recommendations of Staff witness Lamm, which we find to be appropriate for purposes of this case. An audit and investigation of the Company's actual booked fuel expenses and off system sales margins ("OSS margins"), among other things, will be conducted by the Staff after the close of the fuel year. The Commission subsequently determines what are, in fact, prudent and, therefore, allowable fuel expenses, as well as the Company's recovery position at the end of the audit period. For example, the Commission has previously described this review as follows:

Should the Commission find in its Final Audit Order (1) that any component of the Company's actual fuel expenses or credits has been inappropriately included or excluded, or (2) that the Company has failed to make every reasonable effort to minimize fuel costs or has made decisions resulting in unreasonable fuel cost, the Company's recovery position will be adjusted. This adjustment will be reflected in the recovery position of the Company's next fuel factor. We reiterate that no finding in this order is final, as this matter is continued generally, pending Staff's audit of actual fuel expenses.⁶

Likewise, while we find the fuel factor approved herein shall be implemented for service rendered on and after October 20, 2008, no finding in this Order Establishing Fuel Factor is final, as this matter is continued generally, pending audit and investigation of the Company's actual fuel expenses.

The fuel factor approved herein is comprised of: (1) a current period factor of 1.951¢ per kWh based on the Company's projected fuel expenses of \$399,332,927 for the 12-month period ended August 31, 2009, and an OSS margin credit of \$88,694,737 based on the Company's actual OSS margins for the 12-month period ending June 30, 2008; and (2) a prior period factor of

⁶ *Kentucky Utils.*, 1995 S.C.C. Ann. Rept. at 311.

0.209¢ per kWh based on an updated projection of the Company's under-recovered fuel balance of \$33,301,253 in its Deferred Fuel Account as of August 31, 2008.⁷ We find it reasonable, for purposes of this case, to continue our past practice of: (1) approving a fuel factor for Appalachian Power based on twelve months of projected fuel expenses given the price volatility and unsettled nature of current fuel markets; and (2) calculating the OSS margin credit based upon the Company's most recent twelve months of actual OSS margins.⁸ We further find that the Company's prior period factor should be based on an updated projection of the under-recovered fuel balance in the Company's Deferred Fuel Account as of August 31, 2008.

As noted, there is significant volatility in fuel markets. A major factor resulting in the higher fuel factor in this proceeding is the significant and rapid increase in the price of coal. Appalachian Power and its affiliated companies own predominantly coal-fired generation facilities, and increases in the cost of coal translate directly into higher prices for electricity. Other fuels used for generation, such as oil and natural gas, have recently fallen significantly in price from record levels. While we do not yet see evidence that the coal the Company will use during the current period is following a similar pattern, we will direct the Commission Staff to monitor the cost of coal to the Company on a monthly basis. If the Staff finds evidence of a change in the recovery balance that permits the Commission pursuant to § 56-249.6 A 2 of the Virginia Code to adjust the fuel factor downward during the current period, we will review the matter. We recognize that the high price of coal places a burden on all customers.

⁷ Exh. 6 (Lamm direct, Attachments 1, 2 and 4).

⁸ We note that § 56-249.6 D 1 requires that 75 percent of the total annual margins from off-system sales be credited against fuel factor expenses. We have given ratepayers the maximum credit allowed by law, 75 percent of OSS margins, to reduce the fuel factor increase.

Accordingly, IT IS HEREBY ORDERED THAT:

(1) The Company's interim fuel factor of 2.255¢ per kWh shall be decreased to 2.160¢ per kWh effective for service rendered on and after October 20, 2008.

(2) The Company shall forthwith file a revised Schedule F.F.R. (Fuel Factor Rider) reflecting the 2.160¢ per kWh fuel factor approved herein effective for service rendered on and after October 20, 2008.

(3) The Commission Staff shall monitor the cost of coal to the Company on a monthly basis, and shall notify the Commission if there is evidence of a change in the recovery balance that permits the Commission pursuant to § 56-249.6 A 2 of the Virginia Code to adjust the fuel factor downward during the current period.

(4) This case be continued generally.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to:

Anthony Gambardella, Esquire, Woods Rogers PLC, 823 East Main Street, Suite 1200, Richmond, Virginia 23219; Shaun C. Mohler, Esquire, and Damon E. Xenopoulos, Esquire, Brickfield, Burchette, Ritts & Stone, P.C., 1025 Thomas Jefferson Street, N.W., Eight Floor, West Tower, Washington, D.C. 20007; Howard W. Dobbins, Esquire, and Robert D. Perrow, Esquire, Williams Mullen, A Professional Corporation, Two James Center, 1021 East Cary Street, P.O. Box 1320, Richmond, Virginia 23218-1320; Louis R. Monacell, Esquire, and Edward L. Petrini, Esquire, Christian & Barton, L.L.P., Suite 1200, 909 East Main Street, Richmond, Virginia 23219-3095; C. Meade Browder, Jr., Senior Assistant Attorney General, and Ashley B. Macko, Assistant Attorney General, Division of Consumer Counsel, Office of Attorney General, 900 East Main Street, 2nd Floor, Richmond, Virginia 23219; and the Commission's Office of General Counsel and Divisions Energy Regulation, Public Utility Accounting and Economics and Finance.